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COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

AT RICHMOND, DECEMBER 18, 2001

APPLICATION OF

SOUTHSIDE ELECTRIC COOPERATIVE, INC.

CASE NO. PUE000749

For approval of a functional  
separation plan

FINAL ORDER

On December 29, 2000, Southside Electric Cooperative, Inc. ("Southside" or the "Cooperative"), filed an application for State Corporation Commission ("Commission") approval of the Cooperative's plan for functional separation ("Plan") as required by the Virginia Electric Utility Restructuring Act ("the Act"), Chapter 23 of Title 56 of the Code of Virginia (§ 56-576 et seq.)<sup>1</sup> The Act requires that the Commission complete its review of proposed plans of separation by January 1, 2002, and that transition to competition be implemented according to a timeline established by the Commission. Pursuant to an Order issued on March 30, 2001, in Case No. PUE000740, the Commission established January 1, 2004,

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<sup>1</sup> Southside also filed on December 29, 2000, an application for a general rate increase and for approval of a special rate and contract. This application was considered by the Commission in Case No. PUE000750.

as the deadline for Southside and other electric cooperatives to provide full retail access for their customers.

The Commission promulgated rules<sup>2</sup> for functional separation as required by the Act. These Rules require the Cooperative to file a Plan that includes a cost of service study separating the Virginia jurisdictional operations into functions: generation, transmission, and distribution, subdivided by class and specifically identifying the costs associated with metering and billing. The Rules also require that the Plan include proposed unbundled rates, tariffs, and terms and conditions for service. Requests for waiver from the required submission of documents under the various sections of the Rules are also permitted.

In its application, the Cooperative stated that it is currently functionally separated. It does not own or control any generation or transmission facilities, nor does it own or control any affiliated entity that owns or controls generation or transmission facilities. Instead, Southside purchases all of its requirements for demand, energy, transmission and ancillary services through contracts with Old Dominion Electric Cooperative and Southeastern Power Administration. As such, Southside stated that it had no plans to divest itself of any generation assets, to create any new functionally separate

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<sup>2</sup> Commission's Regulations Governing the Functional Separation of Incumbent Electric Utilities under the Virginia Electric Utility Restructuring Act ("Rules"), 20 VAC 5-202-10 et seq., adopted in Case No. PUA000029.

entity, or to propose to transfer any functions, services, or employees to a functionally separate entity or third party. The Cooperative filed a cost of service study, which included proposed unbundled rates to illustrate the Cooperative's rate unbundling. In its functional separation application, the Cooperative did not file unbundled tariff rates and terms and conditions of service, but did so as part of its general rate application in case No. PUE000750. The Cooperative requested that this tariff filing in its general rate application be accepted and used as Southside's compliance with the filing requirements for the functional separation case.

In an Order dated March 19, 2001, in this proceeding and in Case No. PUE000750, the Commission directed the Cooperative to provide notice to the public and established a procedural schedule for the filing of comments or requests for hearing on Southside's application. In that Order, the Commission directed its Staff to investigate the application and file a Report detailing its findings and recommendations on or before June 1, 2001.<sup>3</sup> The Commission also stated that Southside's unbundled tariff filed in the general rate case will be incorporated by reference in the Cooperative's functional separation plan application.

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<sup>3</sup> A subsequent ruling extended the date to June 20, 2001, for Staff to file its report, and permitted Southside to file its response on July 9, 2001.

On June 20, 2001, Staff filed its Report wherein it recommended that the Commission approve Southside's Plan with the adoption of certain modifications recommended by Staff. Specifically, Staff recommended that the Commission adopt the following: Staff's recommendation to consolidate the Cooperative's G&T functions into one function;<sup>4</sup> Staff's adjustments to the Cooperative's per books cost of service study; Staff's allocations of expense and rate base to the G&T function; Staff's recommendation that the Commission direct the Cooperative to track the costs associated with G&T operations; and Staff's recommendation that the Commission direct Southside to provide tariff rates and terms and conditions of service in time for full consideration by the Commission.

On July 9, 2001, Southside filed its Response to the Staff Report. In its Response, the Cooperative did not disagree with Staff's recommendation that the G&T functions be combined, however, it did not agree with Staff's recommendations pertaining to functional cost assignment. Southside requested that the Commission find that its administrative and general ("A&G") expenses and associated overheads are properly assignable to the distribution function because the rate paid by Southside to Old Dominion Electric Cooperative for power supply

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<sup>4</sup> Staff noted that the Cooperative does not anticipate providing transmission service to customers who shop for energy.

and transmission services includes a component for A&G expenses. Southside argued that assigning its A&G and overheads to G&T would, in effect, add a second layer of such costs to the generation component. Further, Southside argued that in its role as the local distribution service provider, it is required by the Act to provide default generation service under its capped rates. According to Southside, supplying default generation services provides a benefit available for all consumers on Southside's distribution system, including those consumers who may choose an alternative power supplier. Southside further stated that the responsibility bestowed on it to provide default service is a function of its role as the distribution utility. Thus, the Cooperative urged the Commission to reject Staff's proposal to assign A&G costs to the G&T functions.

With regard to the Staff's recommendations concerning uncollectible expense, customer deposits, and interest on customer deposits, Southside agreed that a portion of these expenses should be attributed to G&T, but took issue with the Staff's method of allocation. Southside also disagreed with the Staff's assignment of costs to the G&T function relating to the transition to deregulation of generation and relating to load management.

NOW THE COMMISSION, having considered the Cooperative's application, Staff's Report, the subsequent pleadings, and applicable law, is of the opinion and finds that the application should be approved, subject to the modifications detailed herein.

With respect to the issue of the proper allocation of A&G costs supporting the procurement of wholesale power, we find that the Commission has an obligation pursuant to § 56-590 D of the Code of Virginia to see that no cross-subsidies occur. The function causing the cost should be allocated such costs. A&G costs associated with the procurement of wholesale power support the G&T function, and as such, should not be allocated to the Distribution function. We will, therefore, accept Staff's adjustment allocating certain A&G costs associated with obtaining wholesale power to the Cooperative's G&T function. Further, we accept Staff's functional allocation of labor overheads based on the A&G labor factor.

There are two ways that a cooperative may recover A&G costs associated with the procurement of wholesale power. If a customer remains with the cooperative, the cooperative will recover such costs from the customer. If the customer leaves the cooperative, and the embedded cost of generation exceeds the market, the cooperative will have the opportunity to recover the cost through the wires charge.

We likewise agree with Staff that the allocation factor for uncollectible expense, customer deposits, and interest on customer deposits should be based on each function's relative level of operating expense. We believe this is a reasonable approach in this situation as total G&T expense must be calculated in order to determine the level of G&T revenues, and operating expenses can be used to simulate unbundled revenue.

With regard to the costs for load management, we find that these costs should be fully allocated to G&T, and that load management and related costs should be allocated across all customer classes, not just the residential class. Load management costs are clearly related to generation, not distribution. The goal of load management is to reduce energy usage, thereby having a direct impact on generation and purchased power costs. Load management switches installed for peak shaving are a G&T component because they allow the Cooperative to decrease its power costs by negotiating better rates from the supplier, and the Cooperative would not have load management switches simply for distribution purposes. Further, we agree with Staff that since all customers share in the benefits of lower wholesale power bills, all customers should share the costs, not just the residential class.

With respect to the costs incurred by the Cooperative relating to its transition to a competitive generation

environment, we agree with Southside that the full test year level of costs should be allocated to the distribution function since the these costs were incurred by the Cooperative in the course of its responsibilities as a distribution provider.

We find that G&T costs, as defined in this Order, should be tracked prospectively by the Cooperative in order to ensure accurate functional allocations in any future proceedings before the Commission. We also direct the Cooperative to begin tracking the incremental costs associated with billing and collection costs, as well as the activities that give rise to the customer service and legal and regulatory costs.

Finally, in its cost of service study, Southside discusses the impact of its monthly fuel adjustment factor in relation to the determination of the market price for generation and the wires charge. It is the Cooperative's position that fuel adjustments can be applied monthly without violating §§ 56-582 and 56-583 of the Code of Virginia. We are not persuaded by the Cooperative's argument on this point. However, because it is not necessary that we resolve this issue prior to January 1, 2002, we will defer our consideration of it until next year. In the interim, we direct the Staff to (i) consult with Southside, the other electric cooperatives, and any other interested parties on this issue and (ii) submit a written recommendation to the Commission on or before March 1, 2002, on whether we



should implement an annual fuel factor adjustment for the cooperatives in lieu of the current fluctuating monthly fuel charge.

Accordingly, IT IS ORDERED THAT:

(1) Southside's Plan for functional separation pursuant to the Virginia Electric Utility Restructuring Act is hereby approved, subject to the modifications discussed herein.

(2) On or before March 1, 2002, the Staff shall submit a written recommendation to the Commission on whether we should transition to an annual fuel factor adjustment for the cooperatives from the current fluctuating monthly fuel charge, and if so, how such a transition should occur.

(3) Southside shall provide unbundled tariffs and terms and conditions of service to the Division of Energy Regulation that conform to this Order and all applicable Commission Rules and Regulations one hundred fifty (150) days prior to its implementation of retail choice.

(4) This case is hereby dismissed, and the papers shall be placed in the file for ended causes.